

THE 2012 State New Economy Index

Benchmarking Economic Transformation in the States



EXECUTIVE SUMMARY

**“It is not the strongest of the species that survive,
nor the most intelligent,
but the ones most responsive to change.”**

— Charles Darwin

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Executive Summary

More than three years on from the end of the Great Recession, only six states have regained employment levels enjoyed prior to the recession, and 17 states are still more than 5 percent below their pre-recession employment levels.¹ As many state economies continue to struggle through the lingering effects of the Great Recession, a question commonly asked is, “What is this seemingly invisible force that prevents the economy from returning to pre-recession and especially 1990s growth rates?” In other words, why is it that, despite massive monetary and fiscal stimulus, employment seems locked in persistent malaise?

Some argue that the problem is a lack of consumer demand and that more federal government stimulus spending is the answer. Others argue that it is uncertainty over the massive national debt and that fiscal austerity is the answer. However, one diagnosis that has gone largely unnoticed holds that this invisible force is the decline in the competitiveness of the U.S. economy in the global marketplace. As ITIF points out in *Innovation Economics: The Race for Global Advantage*, this decline has been a relatively untold story over the past decade, although its symptoms have clearly manifested in the dramatic fall in manufacturing employment and investment since 2000.² The failure of the United States to adapt to a global economy that is evermore dependent on knowledge and innovation

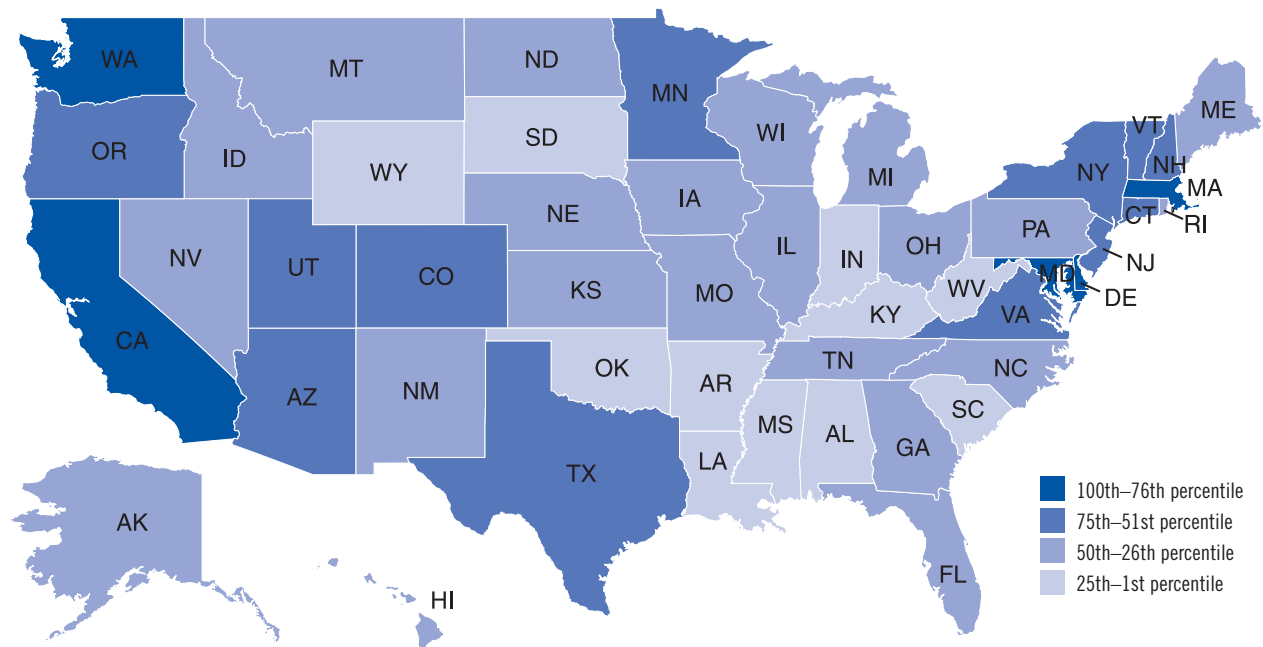
for growth—the so-called “New Economy”—is causing traded sector firms, and manufacturers in particular, to look to other, more competitive countries when it comes to choosing locations. And this loss of traded sector activity, including jobs and investment, holds back the entire U.S. economy and its component state economies as well.

For the United States to be competitive, one key will be to compete more on the basis of innovation and entrepreneurship, and less on cost. With a globalized economy enabling easy access to low-cost production systems in nations like China, India, and Mexico, U.S. competitive advantage will continue to be found in making things and providing traded services that other nations are unable to make or provide as easily or as efficiently. And success in this means, among other things, having a workforce and jobs based on higher skills; strong global connections; dynamic firms, including strong, high-growth startups; industries and individuals embracing digital technologies; and strong capabilities in technological innovation. These keys are the same for state economies and this is why the *State New Economy Index* focuses on these five areas.

The *2012 State New Economy Index* builds on prior *State New Economy Indexes* published in 1999, 2002, 2007, 2008 and 2010.³ Overall, the report uses 26 indicators, divided into those five key areas that best capture what is new about the New Economy:

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Figure 1: Overall score percentile map



1. Knowledge jobs
2. Globalization
3. Economic dynamism
4. The digital economy
5. Innovation capacity

The state that is farthest along on the path to the New Economy is Massachusetts, as it has been in all previous editions of the *State New Economy Index*. Boasting a concentration of software, hardware, and biotech firms supported by world-class universities such as MIT and Harvard, Massachusetts survived the early 2000s downturn and was less hard hit than the nation as a whole during the Great Recession, at least in terms of job growth and per-capita income growth. However, Massachusetts no longer holds the commanding lead it held in the 2010 index; in this edition, it shares the top quartile with Delaware, Washington, California, and Maryland. Second-place Delaware is perhaps the most globalized of states, with business-friendly corporation law that attracts both domestic and foreign companies

and supports a high-wage traded service sector. The state has moved up four ranks from 2010, driven by big improvements in entrepreneurship levels, R&D investment, and movement toward a green economy. Washington state, in third place, scores high due not only to its strength in software aviation, but also because of the entrepreneurial hotbed of activity that has developed in the Puget Sound region, and heavy use of digital technologies in all its sectors. Fourth-ranked California thrives on innovation capacity, due in no small part to Silicon Valley and high-tech clusters in Southern California. California also still dominates in venture capital, receiving 50 percent of all U.S. venture investments, and also scores extremely well across the board on R&D, patent, entrepreneurship and skilled workforce indicators.⁴

Maryland occupies fifth place and Virginia sixth. Their high rankings are primarily due to high concentrations of knowledge workers, many employed with the federal government or related contractors in the suburbs of Washington, D.C. Colorado, in seventh place,

In the New Economy, innovative capacity is increasingly the driver of competitive success.

maintains a highly dynamic economy along with an educated workforce. The state is also a hotbed for venture capital investment in the middle of the country, ranking behind only California and Massachusetts. Eighth-place Utah is ranked number one in economic dynamism while it ranks third in digital economy factors. Moreover, its high-tech manufacturing cluster centered around Salt Lake City and Provo support its first-place ranking in manufacturing value added. Ninth-place Connecticut's success is not based on any one area or indicator. In fact Connecticut does not rank first on any of the 26 indicators; however, the state scores highly across most indicators, having a highly educated population, strong defense and financial industries, and robust R&D investment. New Jersey's strong pharmaceutical industry, coupled with a high-tech agglomeration around Princeton, an

advanced services sector in Northern New Jersey, and high levels of inward foreign direct investment help put it in tenth place. However, relative to its peers, the state has declined in many categories—most notably in entrepreneurial activity, health IT, and initial public offerings—which explains its fall from its fourth-place ranking in 2010.

The two states whose economies have lagged the most in making the transition to the New Economy are Mississippi and West Virginia. Arkansas, Oklahoma, Alabama, Kentucky, Louisiana, South Dakota, Indiana and Wyoming round out the bottom 10. Historically, the economies of many of these Southern and Plains states depended on natural resources or on mass-production manufacturing, and relied on low costs rather than innovative capacity to gain competitive advantage. But, in the New Economy, innovative capacity (derived

Table 1. State ranks and overall scores

2012 Rank	State	2012 Score	2012 Rank	State	2012 Score	2012 Rank	State	2012 Score	2012 Rank	State	2012 Score
1	Massachusetts	92.4	14	Oregon	69.3	27	Maine	58.9	40	South Carolina	49.8
2	Delaware	82.1	15	Vermont	67.2	28	Alaska	58.7	41	Wyoming	49.5
3	Washington	79.5	16	Arizona	66.7	29	Kansas	57.7	42	Indiana	49.4
4	California	79.1	17	Texas	65.7	30	New Mexico	56.8	43	South Dakota	48.0
5	Maryland	79.1	18	Georgia	64.8	31	Wisconsin	55.8	44	Louisiana	46.1
6	Virginia	77.9	19	Michigan	64.5	32	Ohio	55.5	45	Kentucky	45.7
7	Colorado	76.8	20	Illinois	64.3	33	Missouri	54.9	46	Alabama	45.7
8	Utah	76.4	21	Florida	61.4	34	North Dakota	54.1	47	Oklahoma	45.5
9	Connecticut	76.0	22	Pennsylvania	60.6	35	Nebraska	53.7	48	Arkansas	41.7
10	New Jersey	75.6	23	Rhode Island	60.5	36	Hawaii	53.5	49	West Virginia	37.9
11	New York	72.5	24	Idaho	60.5	37	Montana	53.1	50	Mississippi	37.4
12	New Hampshire	71.9	25	North Carolina	60.2	38	Iowa	52.9			
13	Minnesota	69.7	26	Nevada	59.0	39	Tennessee	52.2			

through universities, R&D investments, scientists and engineers, highly skilled workers, and entrepreneurial capabilities) is increasingly the driver of competitive success.

To improve their economic fortunes, states' old economy economic development policies must be adapted to the hyper-competitive New Economy, with states developing comprehensive "innovation strategies." These strategies should focus on three key policy areas:

1. policies to reduce zero-sum competition;
2. policies to spur "win-win" economic results;
3. policies to support the traded sector—manufacturing in particular.

On the first, states should take steps to limit local communities' within-state zero-sum competition and also work to reduce zero-sum competition with other states. On the second, states can expand incentives and programs to spur win-win results that benefit both their state and the nation as a whole by investing in areas that promise long-term growth and innovation. Although many states are facing tough fiscal environments, states can and should also work creatively to identify policies that can spur innovation on a budget, essentially embracing a "poor man's innovation policy." And on the third, both states and the federal government need to implement what ITIF calls the "4Ts" of manufacturing

policy: tax, trade, technology and talent policy. While trade is mostly in the realm of the federal government, there are many policies available to states in the other three areas that can spur traded sector growth.

The current challenge of competitiveness and manufacturing decline is more severe than ever before, and on the federal level, our political system seems less able to respond with the kinds of comprehensive solutions that take the best from "both sides of the aisle" than it has been for at least a century. Until federal action is forthcoming, states will be the level of government best positioned to spur on the process of economic revitalization, but only if they stake out new ground and new approaches. States that score highly on the *State New Economy Index* are best able to face the challenges brought on by the New Economy transformation, while lower-scoring states have significant ground to make up. While low-scoring states would perhaps benefit most from implementing comprehensive and cogent innovation strategies, even the high-scoring states have room for improvement. Indeed, all of the states, and perhaps most importantly, the federal government, need robust innovation strategies in order to compete in the New Economy. Without these, virtually every U.S. state will find itself perpetually stuck in the economic doldrums, unable to reap the job growth and quality of life improvements that the New Economy enables.

1. Bureau of Labor Statistics, Current Employment Statistics (total nonfarm employment, seasonally adjusted, November 2007, August 2012; accessed October 10, 2012), <http://www.bls.gov/sae/>. States that have now have employment higher than pre-recession level are Alaska, Louisiana, New York, North Dakota, Oklahoma, and Texas.
2. Robert D. Atkinson and Stephen J. Ezell, *Innovation Economics: The Race for Global Advantage* (New Haven, CT: Yale University Press, 2012).
3. The first two *State New Economy Index* reports were published by one of the authors when he was with the Progressive Policy Institute. See Robert D. Atkinson and Randall Court, *The 1999 State New Economy Index* (Washington, DC: Progressive Policy Institute, 1999) and Robert D. Atkinson, *The 2002 State New Economy Index* (Washington, DC: Progressive Policy Institute, 2002).
4. "Historical Trend Data," MoneyTree, PriceWaterHouseCoopers, 2012, <https://www.pwcmoneytree.com/MTPublic/ns/nav.jsp?page=historical>;

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